Feet of Clay: Can Megaprojects Distract the Russian People from Sanctions?

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Five years on from their initial introduction, international sanctions on Russia have done little to alter the country’s behaviour on the international scene or domestically. As the sanctions continue to restrict foreign investment in Russia’s infrastructure, authorities are keen to promote the idea of megaprojects – large but often symbolic constructions – as a distraction from Russia’s economic constraints. However, in the long term this strategy may prove short-sighted, as it diverts government funds away from necessary social welfare projects that may increase public dissatisfaction in the coming years.

Western sanctions introduced in response to Russia’s annexation of Crimea and subsequent military intervention in Eastern Ukraine have been in place since March 2014. As the fifth anniversary of the sanctions approaches, much press coverage has focused on the effectiveness of these measures, or how sanctions could prompt Russia to alter its behaviour. However, a look at the Russian authorities’ domestic response to sanctions offers some insight into the government’s approach to distracting its people from economic difficulties in the coming years.

Directly associating Putin’s approval ratings and his foreign policy actions is somewhat lazy analysis

Since the sanctions were introduced, the authorities have increasingly been focusing attention on ‘megaprojects’ – large infrastructure projects that tend to have greater symbolic value than economic benefit. Although these projects are likely aimed at the West in symbolic terms, they are also designed to display to the Russian public that the country is still able to complete major construction projects without Western assistance. However, megaprojects also absorb large amounts of government funding that could otherwise be spent on social services, such as healthcare and education. This short-sighted strategy, adopted for appearances sake, may be a fundamental weakness for the Kremlin in the longer term.

The EU and US sanctions on Russia can be broadly divided between sectoral (economic) sanctions, and individual sanctions, which include visa restrictions, travel bans and asset freezes on Russian and Ukrainian officials thought to be involved in the annexation and the conflict in Eastern Ukraine, or individuals who are thought to be close to President Vladimir Putin. There is a trade embargo in place on Crimea and a ban on export licences for defence products or services to Russia, as well as specific economic sanctions that target pillars of the Russian economy such as oil, gas and defence. EU sanctions are usually extended every six months, rather than expanded, due to significant opposition to further expansion from countries such as Austria, Hungary and Italy, all of which have deep business (particularly energy) ties with Russia. The US sanctions are frequently expanded and have the potential to do greater damage to business in Russia, particularly its megaprojects.

Sanctions’ Status

Evidently, the sanctions have not had the desired effect, in the sense that Russia continues to control Crimea and provides financial and military support to the rebels in Eastern Ukraine. Moreover, the sanctions also do not appear to have altered Russia’s actions abroad. As evidenced by UK Prime Minister Theresa May’s approach to Russia following the poisoning of Sergei and Yulia Skripal in March 2018, pushing Russia into a corner rarely produces the intended results; at the time, May gave Putin an ultimatum of 24 hours to offer an explanation for the attack, which he refused to comply with.

The Russian authorities define a megaproject as having investments worth more than $1 billion and featuring a global aspect

Individual sanctions are designed to sow divisions between wealthy businesspeople and Putin, but regardless of the oligarchs’ dissatisfaction, there is little evidence to suggest that they would be able to pressure Putin into changing his foreign policy. The broader economic impact of sanctions is difficult to assess, partly because they were introduced during a period of fluctuating oil prices, which had a deleterious effect on the Russian economy and prompted a recession.
The Crimean Bridge across the Kerch Strait, 1 October 2018. The bridge links Crimea to the Russian mainland, allowing Russia to establish tighter and more effective control over the annexed territory. At a cost of $3.7 billion, the megaproject also has some tangible economic benefits, such as job creation and demonstrating that Russia is still able to attract some foreign investment despite international sanctions. Courtesy of PA Images/Sergei Malgavko/TASS.
that lasted almost two years, from which the country is slowly emerging.

The Kremlin’s narrative since 2014 has been to claim that the sanctions have been a boon to domestic producers and that Russia has managed to replace most trade from EU suppliers. The EU’s decision to cut off access to European capital markets was particularly damaging for Russia, as its banks are unable to seek long-term financing for large projects. While Russia has not been cut off from the SWIFT international payments system, the US periodically uses this prospect as a threat.

Mindful of the fact that the sanctions are likely to remain in place for the next few years, Russia has begun looking inward for answers – since December 2015, Russia has been developing its own ‘Mir’ credit card repayment systems to circumvent dependence on US-owned Visa and Mastercard. The Russian authorities have continued to promote the idea that the Russian economy is not only able to succeed despite sanctions, but that the economy is over-performing. Megaprojects such as large bridges, stadiums and power plants are one way that the authorities can point to tangible proof of Russia’s economic success, without the assistance of the West. The West is partly the audience for these projects, but the theatre is more for the benefit of the Russian public.

**Why Public Opinion Matters**

The Russian public’s view is important to Putin and is often the audience for his domestic and foreign policy actions. However, many Russian watchers tend to over-emphasise Putin’s fluctuating approval ratings, noting that they increased during Russia’s foreign interventions in Eastern Ukraine, Crimea and Syria. This tends to conflate the Russian public’s dissatisfaction with depressed wages with Russia’s foreign policy designs on countries such as the Baltic states.

This is an issue for several reasons. Directly associating Putin’s approval ratings and his foreign policy actions is somewhat lazy analysis – surveys in Russia are usually only able to reach a handful of the population of 143 million, and people usually answer them based on what the surveyor wants to hear. Ordinary Russians are much more interested in the latest pension reform that would see men work for an additional five years, than they are in Russia’s actions in Syria. Most importantly, there is a difference between responding negatively to survey questions about Putin and protesting in the streets with the aim of ousting the government. But Putin does not ignore the public – the unpopular pension reform was eventually watered down – and he is aware that sometimes the domestic audience must be catered to.

**Megaprojects – A Convenient Distraction**

Instead of clumsy foreign interventions, the government has many other ways of distracting the Russian people from economic pressures. This includes a sustained media campaign on how the sanctions can be spun as a success for the economy, to increasingly visible megaprojects showcasing Russia’s ability to pull off infrastructure improvements in the face of economic adversity.

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The Russian authorities define a megaproject as having investments worth more than $1 billion and featuring a global aspect – usually involving several countries or with multiple foreign investors. In this vein, the government has allocated investments of $24 billion for ‘infrastructure’ by 2022, which would include projects such as new airports and roads, and has also set up a development fund worth RUB 3.5 trillion ($52.3 billion) to cover infrastructure spending until Putin’s term in office ends in 2024. Any state involvement in megaprojects is likely to be paid for out of this budget, although the extent to which already planned projects would absorb this fund is unclear. Diverting budget towards large but ultimately hollow infrastructure projects will mean that there are fewer funds available for simpler tasks such as resurfacing roads in economically repressed areas.

Recent megaprojects include the 2014 Sochi Winter Olympics, which cost around $50 billion, and the most recent FIFA World Cup in June/July 2018, involving the construction of stadiums in 11 cities and totalling around $15 billion. However, there is a clear distinction to be drawn between megaprojects that claim to serve an economic purpose and those that have a political function. Unlike the World Cup, megaprojects such as the bridge linking Russia to Crimea will allow Russia to establish tighter and more effective control over the annexed territory, as well as over the flow of goods and people. The bridge cost $3.7 billion, and will likely be completed at the end of 2019, making the easing of sanctions related to Crimea almost impossible. Visible projects of this kind do have some tangible economic benefits, such as creating jobs (particularly construction) and bringing companies to the region, as well as indicating that Russia is still able to attract foreign investment. Russia still values foreign investment; one of Putin’s goals laid out upon his inauguration in his 2012 May Decrees (a series of aims that Russia should meet in the coming years) was that Russia should enter the Top 20 of the World Bank’s ‘Doing Business’ ratings by 2018. Russia has significantly raised its rankings since then, and in 2019 was in 31st place. The sanctions have obliged Russia to seek alternative trade partners in countries such as Japan, China and South Korea, with some limited success. Russia has been courting China for investments in
some of its megaprojects, such as the 2024 launch of two large petrochemical production plants owned by Sibur – a private company. Chinese companies, including Sinopec, have bought up significant stakes in Sibur, which expects much of its product to be exported to China.

While political disputes are deterring large-scale Japanese and Chinese investment in Russia, the US sanctions pose an additional practical risk. US sanctions are more restrictive than EU sanctions, as they go beyond Russia's actions in Crimea and Eastern Ukraine by targeting Russians that the US claims are involved in 'malign activity' abroad, including election interference, human rights abuses, and corrupt individuals thought to be responsible for the attack on the Skripals. The secondary sanctions are a particular issue, as they threaten to introduce restrictive measures on people related to or in business with sanctioned individuals. As the Mueller inquiry continues to investigate allegations of Russian involvement in the US presidential elections in 2016, the US Treasury is likely to periodically expand sanctions on Russia. There is a risk that any foreign joint venture partners involved in projects in Russia would have to quickly divest their shares should a partner company fall under sanctions, which is likely to deter foreign investors and could jeopardise many of Russia’s megaprojects.

**House Without Foundation**

But in reality, megaprojects epitomise many of Russia’s systemic problems, particularly entrenched corrupt practices. Large sprawling projects benefit few except the companies involved in construction tenders – usually companies owned by Putin's associates such as Arkady Rotenberg, whose company Stryogazmontazh is overseeing the construction of the Kerch Bridge to Crimea, a lucrative contract it allegedly won without an open tender. Construction of the World Cup stadiums was rife with corruption allegations, including the large-scale theft of project funds, allegations of labour exploitation and abuse of workers on construction sites, and serious health and safety violations. Perhaps inevitably, after the World Cup many stadiums in smaller and underfunded regions have remained empty. Local football clubs are unable to afford the rental costs and the federal government has only pledged financial support for the maintenance of seven stadiums.

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High-profile events of national importance are often paid for by the government. The Winter Universiade – a high-profile sporting event hosted in the southern city of Krasnoyarsk in March 2019 – will cost RUB 40.5 billion ($668 million), designed to showcase Russia’s sporting prowess and also intended to give some economic benefits to locals in the region. However, large projects of this kind are often mired in controversy – in Krasnoyarsk, locals have complained that officials have ordered to cover up dilapidated parts of the city with fake façades which will be torn down once the competition is over. Locals also claim that the city is highly polluted thanks to a nearby factory, blanketing the area in smog. The local authorities have handed out smokeless coal for residents to use, with the stipulation that it be burned around the time of the competition. Evidently, once the event is over, locals are unlikely to gain many long-term benefits from it. Moreover, the Russian authorities do not always have the budget to fund such large projects and must attract external investment. Putin has ascribed almost national importance to another megaproject, a land and railway bridge between the Far Eastern Sakhalin Island and the mainland, and another linking the island to Hokkaido in northern Japan, at an estimated cost of $100 billion. The bridge is unnecessary and useful only as a symbol of Russia’s intent to deepen trade with Japan – it would be located in a sparsely populated (around 500,000 people) and poorly connected region that would require multiple other road links for the bridge to have any real benefit for locals. Japanese businesses mostly rely on shipping tankers to move goods into Russia, and so constructing a land bridge is not required. The sheer expense of the project is unaffordable without external assistance, but while Russia has sought investment from the Japanese, they have demonstrated little interest. Japanese business is wary of being in violation of the US’s secondary sanctions. This lack of investment reduces the likelihood that the Sakhalin bridge will be completed on time, but given its symbolic importance to Putin, government funds are likely to be diverted to support it and other Russian investors may be encouraged to participate instead.

Perhaps more importantly, the amount required to construct both the bridge and a double-track railway totals more than the federal budget’s expenditure for 2017 on healthcare. The government's prioritisation of grand megaprojects will mean that fewer funds will be allocated to important but intangible and less impressive-looking endeavours, such as improving healthcare or teacher training. In the long term, the government’s tools to distract the Russian people from economic pressures and the inevitable waves of US sanctions will likely come at the taxpayers’ expense.

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